

General Information Letter: Prior to effective date of Public Act 91-541, no subtraction is allowed for wages whose deduction is disallowed under IRC Section 280C because the taxpayer has claimed a Work Opportunity Credit with respect to such wages.

January 12, 2000

Dear:

This is in response to your letter dated January 6, 2000, in which you request a letter ruling. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter you have stated the following:

Please be advised that with this letter we are protesting the handling of Work Opportunity Credits and the phantom income associated with the tax credits. We have had a discussion your account management division regarding this subject and do not agree with their additional tax assessment in this matter. We do not see how the State of Illinois can be allowed to tax phantom income associated with work opportunity tax credits. This phantom income is added to adjusted gross income on the federal tax return in order to be allowed to take a tax credit of the same amount. This is not additional income. Seeing that the State of Illinois does not recognize these credits, it is totally unfair to charge the taxpayers a tax on something that is not income. The State is not only collecting a tax of 1.5% of this phantom income from the corporation but it is also collecting a 3% tax on this phantom income from the partners of this partnership.

The federal government has a tax policy they call the tax benefit rule. This rule prevents a taxpayer from being penalized in situations where the application of the tax law that was intended to help taxpayers would not, by quirk of the intended law, injure the taxpayer. This would seem to be the situation here, where the State is attempting to apply only one half of the tax law passed by the IRS. If the State wants to tax this phantom income then they should allow an appropriate tax credit to more than offset the additional tax.

### **Response**

Section 51 of the Internal Revenue Code allows a "Work Opportunity Credit" to qualifying taxpayers. The credit is based on certain wages paid by the taxpayer. Section 280C of the Internal Revenue Code provides that, if a taxpayer has claimed the Work Opportunity Credit with respect to certain wages, that taxpayer's deduction for such wages must be reduced by the amount of the credit. Thus, the taxable income of a taxpayer who has claimed the credit is effectively increased by the amount of the credit.

Section 203 of the Illinois Income Tax Act (the "IITA"; 35 ILCS 5/101 *et seq.*) provides that a taxpayer's base income is equal to its federal taxable income (or adjusted gross income, in the case of an individual taxpayer), modified as provided in that section. Section 203(h) provides:

Except as expressly provided by this Section there shall be no modifications or limitations on the amounts of income, gain, loss or deduction taken into account in determining gross income, adjusted gross income or taxable income for federal income tax purposes for the taxable year, or in the amount of such items entering into the computation of base income and net income under this Act for such taxable year, whether in respect of property values as of August 1, 1969 or otherwise.

For individuals, Section 203(a)(2)(M) of the IITA currently allows individuals to subtract from their adjusted gross incomes:

With the exception of any amounts subtracted under subparagraph (N), an amount equal to the sum of all amounts disallowed as deductions by (i) Sections 171(a)(2), and 265(2) of the Internal Revenue Code of 1954, as now or hereafter amended, and all amounts of expenses allocable to interest and disallowed as deductions by Section 265(1) of the Internal Revenue Code of 1954, as now or hereafter amended; and (ii) **for taxable years ending on or after the effective date of this amendatory Act of the 91st General Assembly**, Sections 171(a)(2), 265, **280C**, and 832(b)(5)(B)(i) of the Internal Revenue Code; the provisions of this subparagraph are exempt from the provisions of Section 250. (emphasis added)

Substantially identical provisions are included in Section 203 for taxpayers other than individuals.

As provided in Section 203(a)(2)(M) and the similar subtraction modifications, taxpayers are allowed to subtract the amount of wage deduction disallowed under Section 280C only for taxable years ending on or after August 13, 1999, the effective date of Public Act 91-541. Accordingly, no such subtraction is allowed for prior years.

The IITA makes no express provision for a tax benefit rule. Accordingly, Section 203(h) of the IITA prohibits the allowance of any subtraction based on the tax benefit rule.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Sincerely,

Paul S. Caselton  
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